Appendix A – WDBC Commercial Property Investment Strategy & Criteria

Overall Objective:

Increase revenue streams to contribute to the financial sustainability of Council, enabling it to continue to deliver and/or improve frontline services in line with adopted strategy & objectives.

This will be achieved by the focussed acquisition of existing commercial property assets using predominantly prudential borrowing or any other unallocated or available Council reserve or capital receipt.

Strategy

- Invest in commercial properties to provide rental income with a minimum gross yield of 5.85% across the portfolio (once complete)
- Achieve a spread of risk across a greater number of assets and by acquiring properties across the range of different property asset classes, namely retail, leisure, office, industrial or alternative (e.g. health, PRS, energy)
- Properties will be acquired to hold for the short to medium term rather than to dispose
- The Council will operate independently - The Council is not reliant on another Council to progress with this strategy
- The Council will invest so that the portfolio's net revenue receipt delivers sufficient income to fund the initiative and make a significant contribution to the Council's forecast budget gap (with the potential to meet the budget gap)
- Acquisition costs are forecast not to exceed 7% (Stamp Duty Land Tax (SDLT) / Legal / Agents / Due Diligence). These services are to be commissioned via a procurement exercise.
- Management of the acquired assets will be outsourced to property professionals. The cost of this management will be included within the target return
- The legal work required to complete transactions is to be outsourced
- Specialists will be commissioned to act on behalf of the Council to source suitable properties and manage the acquisition due diligence process

Risk

- The risks of investing in property may be mitigated through the acquisition of assets with secure, long income streams
- This needs to be balanced against the requirement for a given level of income yield on capital invested in a careful and controlled manner, with specific analysis of risk criteria carried out in the 'due diligence' stage prior to the completion of each purchase
- Once fully invested, should the portfolio yield drop below 5.85%, a review of the strategy will be triggered
- The portfolio of investments being acquired should be diversified in order to spread risks via a balanced portfolio, such diversification principally being across geographical locations and the use type of properties
- The portfolio will be relatively risk-averse, when appropriate, limiting fresh investment to properties with minimum unexpired lease terms of five years at the date of acquisition, and tenants of strong financial standing

Initially, investment decisions will be taken as long as they fit within the below criteria:
Location:

- Neutral – wherever opportunities arise in order to quickly acquire good investment properties which deliver the minimum prescribed yield and are deemed an acceptable risk

- In order to not over expose the Council to one particular geographical area, properties outside of the Council's area will be favoured
- As the portfolio gets larger, a mix of locations will be sought to create a balanced portfolio
- A maximum exposure of 25% per location is sought once the investment budget is exhausted
- Good, commercially strong locations to protect capital value and ensure ongoing occupier demand. E.g. for retail good out-of-town retail clusters/parks; for offices close to transport infrastructure and catchment for employees; for industrial close to major road / rail hubs

Sector:
- Neutral – Wherever opportunities arise in order to quickly acquire good investment properties which deliver the minimum prescribed yield and are deemed an acceptable risk
- As the portfolio gets larger, a mix of sectors will be sought to create a balanced portfolio
- A maximum exposure of 25% to one sector will be sought once the full investment budget is exhausted

Tenant mix:
- As the portfolio gets larger, a mix of tenants will be sought to create a balanced portfolio
- A maximum exposure of 15% to one tenant will be sought once the full investment budget is exhausted
- The final decision over the appropriateness of any tenant would be reviewed at the time of acquisition

Lease length:
- Minimum 5 years unexpired (mean unexpired term for multi-let properties)
- Unless in exceptional circumstances (e.g. the property is being purchased with a view to re-development or the property is located in a prime location), single-let properties will not be favoured
- For multi-let properties, a mix of lease expiry dates are preferred, thereby limiting void risk (unless the property is purchased with a view to re-development)
- Properties are to be well-let to sound tenants on leases with a preference for 'Full Repairing and Insuring' leases for single occupiers and through internal repair obligations and a service charge for multi-let properties
- The final decision over the definition of "well-let" and "sound" will be agreed between the property acquisition advisers (including legal due diligence) and the individuals delegated with the responsibility to conclude the acquisition of the properties
- This decision will be based on both the risk to the capital investment and revenue returns

Investment Yield:
- Per investment lot, a minimum gross yield of 4.0% will be sought, before management, maintenance and funding costs
- A maximum gross yield in excess of 11% will not normally be sought
- As the portfolio gets larger, a mix of yields will be sought to create a balanced portfolio
- The overall portfolio will have a target balanced portfolio yield of 5.85%

Cost:
- Individual lot sizes of up to £15m
- Larger lot sizes are favoured - smaller size properties have disproportionately higher management costs and expose the Council to greater property void risks
- All investments will normally be subject to a minimum lot size of £3m

<u>For all of the above, flexibility of +/- 15% (relative to the measure) is allowable in order to conclude a deal without recourse to reviewing the terms of this strategy. The overall budget for acquisitions is not subject to this flexibility.</u>

Funding:

- This is to be secured on a case by case basis on the most favourable terms available predominantly through prudential borrowing or any other unallocated or available Council reserve or capital receipt
- The term will not exceed the expected remaining life of the property, but as a rule, the Council wishes to secure borrowing over a maximum 50 year term
- The Council will opt to borrow monies on the most commercially advantageous terms, seeking advice from its retained Treasury Management Advisors

Exit Strategy:

- The Council is investing to hold for the short to medium term. It is not looking to actively trade commercial property in this timeframe
- If capital values determine that the most prudent action is to sell an individual asset, this will be considered on a case by case basis and will be acted upon in consultation with the 'Invest to Earn' group Chair, Leader, S151 officer and Head of Paid Service
- It is proposed that all properties will be held as Council Assets. This may change if the Council were to set-up an arms-length management organisation (ALMO) or trading company and it was found to be commercially advantageous for such a vehicle to hold the asset
- It is important to note that there would be early repayment charges if the loan used to acquire the commercial property were to be repaid before the end of the loan term. However, Public Works Loan Board (PWLB) lending is not secured against property, so this would not inhibit the asset being traded during the loan period. An alternative asset would need to be purchased (& held) with any sale proceeds

Tax Implications:

- Due to the Council holding the asset, it is not anticipated that there will be any corporation tax or income tax implications from this strategy
- Some properties may be VAT elected, meaning VAT must be charged to tenants. This will be dealt with on a case by case basis and will be covered by the due diligence connected with that acquisition. The Council is able to charge and recover VAT
- Capital Gains Tax would not apply to assets sold from Council ownership. This position may change if a company were to be used to hold the acquired asset

Governance Arrangements:

Purchase

Purchases must conform to the adopted commercial property investment strategy. Any deviation from the agreed strategy (beyond the flexibility parameters) will require Council approval.

Delegated authority to be given to the Head of Paid Service, in consultation with the S151 officer and Leader and Chair of the 'Invest to Earn' group. Each receive one vote to proceed with purchase. In the event of a split decision, the S151 officer has the casting vote. Only purchases which are in line with the agreed strategy will be considered by this group. The 'Invest to Earn' group will determine its chair and will receive details of potential purchases from the Assets CoP. They will vote on whether to bring a potential purchase decision to the Head of Paid Service.

Running / Review
Assets to be managed by a contracted third party initially, with overview by Assets CoP, Group Manager, Business Development and the S151 officer. Invest to Earn group to receive regular reporting to confirm portfolio composition and performance. Regular reporting to Audit Committee.

Disposal
Once acquired, decisions relating to the ownership of any acquired properties will be dealt with in line with the Council's constituted scheme of delegation

Disposal will be considered if the portfolio breaches the approved strategy. Decisions to be made in consultation with the 'Invest to Earn' group Chair, Leader, S151 officer and Head of Paid Service.